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To Whom It May Concern:

I am writing from the Woodstock Institute in Chicago to comment on the Advanced Notice of Proposed Rulemaking on the Community Reinvestment Act regulations. The Woodstock Institute is a 28-year-old nonprofit organization that is dedicated to promoting community reinvestment and economic development in low-income and minority communities. We believe that it is vitally important that we do not lose the progress made in the 1995 revisions to the CRA regulations. While CRA is far from perfect, it has become considerably more effective in opening new markets since the 1995 changes. The attached document outlines our detailed responses to all of the questions outlined in the ANPR.

Thank you for your attention to these matters. Please let me know if you have questions about our response or if you require further information.

Sincerely,

Malcolm Bush
President

Attachment

Section 1. Large Retail Institutions: Lending, Investment and Service Tests:

Question 1 Do the regulations strike the appropriate balance between quantitative and qualitative measures, and among lending, investments, and services? If so, why? If not, how should the regulations be revised?

Answer: In order for the regulations to maintain their focus on outcomes over processes, quantitative measures should remain a significant emphasis. At the same time, improvements in measurements that incorporate qualitative differences in lending, investment, or service activities are needed. There is not a zero-sum tradeoff between quantitative and qualitative evaluation. Both are needed and should be improved. For example, analyzing a bank's lending for costs and abusive terms is critical. This qualitative work does not suggest less quantitative analysis, but in fact necessitates more sophisticated quantitative analysis. Rather than merely measuring lending volumes, examiners should distinguish between different types and costs of lending.

In the past, some banks have commented that a focus on quantitative measures forces unhealthy competition and leads to unprofitable activity. First, there are many cases in various markets where, for a period of time, competition drives prices down quite low—even below levels that appear to be profitable. Banks and other firms frequently offer low-priced teaser rates and prices to capture market share and build scale. It is not clear that this activity is any more prevalent in CRA market segments (i.e., low- and moderate-income communities) than in more affluent segments. Banks and other corporations often engage in "loss leaders" that enable them to penetrate all sorts of markets. Short-term losses may be necessary to "prime the pump" or to stimulate market formation. Moreover, if a bank has earned a reputation as a redlining or discriminating institution in a community, it may need to take some short term losses to reenter that market.

To our knowledge, there has been no systematic, independent study of lending to lower-income communities that shows that significant losses are being incurred. The claims of regulated institutions citing their own experiences cannot be considered credible evidence. Similarly, independent studies based on such claims are not reliable. The accounting of profits or losses by product line is problematic in itself. Banks can easily modify their accounting of revenues and expenses to show losses. Loss leader and cross selling issues mean that an apparent loss on a product line might easily be made up for by another line. Moreover, customers that are moderately profitable today may be more lucrative customers in years to come. Of thousands of bank and thrift failures over the last twenty years, none have been shown to have been caused by imprudent CRA lending or investments. In fact, research by the Federal Reserve Board has demonstrated that, among banks specializing in mortgages, those making more loans to low- and moderate-income borrowers or communities are no less profitable than those that do not (G. Canner and W. Passmore. *The Community Reinvestment Act and the Profitability of Mortgage-Oriented Banks*. Board of Governors of the Federal Reserve System, Finance and Economics Discussion Series. No. 1997-7. Jan, 1997).

Regarding the weighting and consideration of the component test areas, the lending test should remain the test with the greatest weight. The Act's history and continuing banking issues both point to the need to place emphasis on the lending test. There are many reasons to remain concerned with the role of banks and thrifts in the mainstream provision of retail credit. This does not imply that investments and services are not important. Indeed, the evaluations of all three types of activities are complementary and necessary.

There should be some increased attention given to assuring that depositories maintain some minimal level of investment and service performance. No bank should receive an overall Satisfactory rating if it receives a Substantial Noncompliance rating on any component test or if it receives a Needs to Improve rating on more than one test. There are insufficient consequences for a bank performing poorly on the investment and service tests. No bank should receive an Outstanding rating if it receives a Needs to Improve rating on any component test. The requirement that a bank must receive at least a Low Satisfactory on the lending test to receive an overall Satisfactory should be retained.

Part A, Question 1: Does the lending test effectively assess an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

Answer: It is vitally important that the lending test continue to be a key component of CRA performance evaluations. The location, distribution, volume, and quality of an institution's residential, small business, and consumer lending are all of primary concern, from a legislative history perspective and because of continuing mainstream credit needs. There is ample evidence of continuing problems in access to retail credit, particularly in lower-income and minority communities. The explosion of predatory lending, the continued evidence of discrimination and redlining in both mortgage and small business lending markets, and the growth of the payday lending industry all point to the need for continued CRA regulation of mainstream lending products. There is significant evidence that the movement to performance-based measures in CRA evaluations has led to some improvements in home loan markets—especially for home purchase loans (R. Litan, N. Retsinas, E. Belsky, P. Leonard and M. Kennedy. *The Community Reinvestment Act After Financial Modernization: A Final Report*. January 2001. US Department of the Treasury).

Notwithstanding the importance of maintaining the lending test, there are a number of issues that the agencies should address in regulatory review. First, originations should be evaluated separately from purchased loans, especially when loans are purchased from other lenders (rather than mortgage brokers). Originations should be given more weight than purchases, especially if the purchases are of seasoned loans. While providing liquidity may provide an important function, especially for nonconforming products, the emphasis on origination is required to ensure a healthy market with substantial numbers of originators. Originations document a continuing influx of credit into a neighborhood or to a particular group of people and are a much better indicator of a bank's commitment to providing credit to underserved areas and persons.

Second, geographic distribution criteria should include race of neighborhood as well as income level. The CRA statute provides that examiners assess an institution's record of meeting the credit needs of the entire community [12 USC 2901 s.804 (1)]. Many geographic lending disparities are more pronounced by race of neighborhood than by income. For example, in the Chicago area, the market share of refinancing loans of subprime lenders in middle-income African-American neighborhoods is more than four times that in middle-income white neighborhoods.

Third, the regulations should direct examiners to evaluate the quality as well as the quantity of an institution's lending. Fair lending and consumer compliance exams may uncover problems of disparate treatment in lending terms or outright violation of consumer lending laws. However, the CRA exam process should also assure that institutions that are doing more responsible lending receive more credit than those that are doing less responsible lending. Moreover, lenders that make legal but problematic loans should be penalized under CRA.

The regulations should call for an examination of subprime loans for predatory features, including excessive up-front fees (more than 4 percent of the total loan amount), heavy prepayment penalties

(more than 2 percent of the principal), single-premium credit insurance, mandatory arbitration, or back-end debt-to-income ratios above 50 percent. Lenders making a significant number of these loans should receive no higher than a Needs to Improve lending test rating. If a lender makes a claim that loans with the features mentioned above are somehow beneficial to the borrower, the lender should be compelled to demonstrate this on a loan-by-loan basis. The origination or purchase of any loans (mortgage or consumer) that violate state or federal lending laws should result in a Substantial Noncompliance lending test rating. Examiners should also compare the pricing and terms of prime and subprime loan products across different types of neighborhoods (by income level and racial composition) and the different products' market shares in different types of neighborhoods (by income and race). Any lender significantly engaged in payday or auto title lending at or above standard industry rates (well above 200 percent APR), should receive no higher than a Needs to Improve on the lending test.

Lastly, the regulation's definition of home mortgage loan should explicitly include all home-secured loans. Lending for different purposes (purchase, refinance, home equity, etc.) should be evaluated separately. The performance context may identify particular community needs or concerns that lead examiners to consider some products more important than others. For example, in communities where predatory refinance lending is a particular concern, examiners should pay special attention to whether an institution is providing adequate levels of fairly priced refinance loans to lower-income families and neighborhoods.

Part B, Question 1. Does the investment test effectively assess an institution's record in helping to meet the credit needs of its entire community? If so, why? If not, how should the regulation be revised?

Answer: The investment test is critical to evaluating an institution's record of helping to meet the credit needs of its entire community and should be retained as a separate test. Moreover, institutions not receiving at least a Low Satisfactory on the investment test should not be able to receive an overall rating of Satisfactory or Outstanding. Investments are critical to the capacity of nonprofits, community development banks, and others to serve the credit needs of those not well served by regulated depositories.

Investments in community development financial institutions (CDFIs), for example, enable CDFIs to leverage the necessary debt capital to maintain adequate lending capacity and to do so with adequate debt-equity balances. These CDFIs, in turn, are able to meet many credit needs that are unmet by conventional financial institutions. The need for such alternative lenders may be due to discrimination or redlining, or market failures in which private, individual institutions do not have incentives to lend to projects where the aggregate social return is positive. CDFIs and other recipients of investments often provide market innovations that are later picked up by conventional financial institutions. For example, in Chicago in the 1970s and 1980s, South Shore Bank had a critical role in fostering the market for financing the rehabilitation of multifamily apartment buildings. When it began this sort of lending, few conventional lenders made such loans. Decades later, Shorebank finds itself competing with many larger institutions that have entered this sector. Early investments in Shorebank were critical to this development.

Currently, performance evaluations do not distinguish between very different types of investment activity to determine the investment test rating. Grants, deposits in eligible institutions, investments in non-targeted SBICs, and other disparate investments are summed with no explicit weighting or disaggregation. The sum of investments is sometimes then compared to a bank's own equity capital. This overly simple analysis does not adequately distinguish between lower- and higher-risk investments, or between higher-return and lower-return investments (the former being very likely to

be provided by the private market). A \$100,000 investment in a Small Business Investment Company that does not target lower-income areas or minority-owned firms and is expected to have a rate of return of 20 percent may receive as much credit as a \$100,000 long-term, subordinate investment in a nonprofit CDFI that does difficult-to-finance real estate projects in low-income communities and can only provide a modest rate-of-return. The regulations ask examiners to consider the responsiveness to community needs and the extent to which the private market meets a need. The regulations should direct examiners to consider community needs more explicitly. Specifically, the current provision that states that banks will receive credit for investments that are not "routinely provided by the private market" should be taken very seriously during exams. Each category of investment should be measured relative to a bank's equity capital. Grants should be measured against a bank's recent earnings.

All investments in mortgage- and asset-backed securities should be reviewed for predatory or illegal lending practices. (See description of such practices in Section 1, Part B, Question 1). Any investments in securities that are backed by illegal loans should result in a Substantial Noncompliance rating under the investment test. If securities are backed by predatory, but not illegal, loans, the institution should receive no higher than a Needs to Improve on the investment test.

Part C, Question 1: Does the service test effectively assess an institution's record of helping to meet the credit needs of the entire community? If so, why? If not, how should regulations be revised?

Answer: The provision of basic retail banking services is critical to the financial health of low-income people. The service test should be applied to all institutions that provide retail banking services, however those services are delivered. No institution that receives lower than a Low Satisfactory rating on this test should receive an overall rating of Satisfactory or Outstanding.

Currently, the service test does not assess performance—it uses delivery channels as proxies for ensuring that services are provided to low-income customers. Most institutions provide little or no documentation that (1) the products meet community needs (especially the needs of the unbanked); and (2) are being used. The test provides few incentives for banks to develop and market retail products for lower-income consumers. Service test criteria are broad and difficult to measure, and financial institutions are inconsistently examined.

Examiners are required to consider the current distribution of branches and, in the context of that distribution, the bank's record of opening and closing branches [228.24 (d) (1 and 2)]. In the CRA exam process, emphasis should be placed on branches because of the benefits they bring to a community. Special weight should be given to the current distribution of branches since the more recent record of opening and closing might conceal an inadequate initial distribution. In addition to branches, examiners should assess whether an institution provides multiple alternative access points. This is especially important as many banks impose teller fees and automation is encouraged to decrease costs. Alternative delivery systems include full-service ATMs; telephone or Internet banking; money order machines; and debit or payroll cards. Examiners should also consider distribution of bank accounts by income, race and geography. The CRA statute expressly includes deposit services in the definition of convenience and needs. [S. 802 (a) (2)].

In order to receive an Outstanding rating on the service test, banks should provide lifeline banking products, multiple delivery systems, and alternatives to standard retail accounts. Banks should also be encouraged to promote financial literacy training. Financial institutions should be required to adopt innovative and complex services in order to receive an Outstanding rating on the service test. In particular, they should work to widen access to the financial mainstream through such mechanisms as

“smart ATMs,” automated money-order dispensers, electronic bill payment, low-cost check cashing, money orders, wire transfers and electronic bill payment services.

Predatory financial practices are not limited to direct retail lending. Banks are also involved in partnerships with firms such as payday lenders. Banks should not receive higher than a Needs to Improve rating on the service test if they form alliances with firms that harm lower-income people. Also, financial institutions that are unable to directly provide services to low-income consumers (i.e., trusts, many Internet banks) should be required to identify alternative strategies and document their support for or alliances with community development financial service providers in order to receive a Satisfactory rating on the service test. Alternatives to direct service provision include:

- Providing grants, non-member deposits and investments to community development credit unions (CDCUs) that provide lifeline banking services and products.
- Sponsoring financial literacy workshops in cooperation with community partners.
- Supporting financial literacy providers, including consumer credit agencies, job training programs, community colleges, etc.
- Providing funding and technical support for financial literacy curricula for low-income consumers.

Part D, Question 1: Are the definitions of community development and related terms appropriate? If not, should the regulations be changed?

Answer: The current definition of “community development”¹ is too broad. In particular, “activities that promote economic development by financing small businesses and farms” is far too general a description of eligible economic development activities under the community development definition. This description can be conceivably applied to almost any loan, investment, or service to any type of small business (which could have as many as 500 employees). Business development activities should meet the following criteria to fall under the definition of “community development”: 1) affected firms are small businesses located in low- or moderate-income geographies or are minority-owned; and 2) the activity of the firm is not perceived as deleterious to the community (payday loan stores, liquor stores, etc.).

Part D, Question 2: Are the provisions relating to community development activities by institutions that are subject to the lending, investment and service tests effective in assessing those institutions’ performance in helping to meet the credit needs of their entire communities? If so, why? If not, how should the regulations be revised?

Answer: The regulations should maintain the lending, service and investment tests. The three component tests are vital to ensuring adequate examination of bank performance. Mainstream direct lending and service activity has always been at the heart of CRA and should be a major focus of examinations. Loans, investments and services that are not counted as “community development” but rather are counted under the mainstream portions of the component tests are of a scale that far exceeds the scale of activities that are eligible for community development credit. This mainstream activity is of vital concern to communities and is a central focus of the legislative history of CRA. Community development activities in all three categories are important and should be evaluated in each component test. If all three areas were considered together, the importance of specific

¹“Community development” currently includes affordable housing (including multifamily rental housing) for low- or moderate-income individuals; community services targeted to low- or moderate-income individuals; activities that promote economic development by financing small businesses and farms; and activities that revitalize or stabilize low- or moderate-income geographies.

components would be weakened by this aggregation. The consolidation would ignore the true credit needs of a community and would deplete the meaning of the performance context, which should highlight community needs in all three areas.

Section 2: Small Institutions: The Streamlined Small Institution Evaluation

Question 1: Do the provisions relating to asset size and holding company affiliation provide a reasonable and sufficient standard for defining "small institutions" that are eligible for the streamlined small institution evaluation test? If so, why? If not, how should the regulations be revised?

Answer: The current definition of a "small institution" is: *An institution with total assets of less than \$250 million that is independent or is affiliated with a holding company with total bank and thrift assets of less than \$1 billion as of the two preceding year ends.* This definition should not be liberalized to include more institutions; the thresholds should remain the same. In the year 2000, over 8,600 banks, or more than 80% of all banks, fit this small institution definition. This means that the vast majority of banks are already examined under the very-streamlined CRA exam procedures that were finalized in 1995.

There is a disturbing history of attempting to roll back CRA for small institutions. During negotiations on the Financial Modernization Act in 1999, it was proposed that banks with under \$100 million in assets be exempt from CRA entirely. At the time, this would have left 38% of all banks—and over three-quarters of banks in rural areas—without any obligation to serve low-income people and communities. Fortunately, this provision was not adopted. If the definition of small banks is expanded to include more institutions, consumers will lose out, as fewer financial institutions will be required to submit detailed accounts of how they serve their communities.

Question 2: Are the small institution performance standards effective in evaluating such institutions' CRA performance? If so, why? If not, how should the regulations be revised?

Answer: The small institution performance standards are not effective in evaluating a small bank's performance. The Federal banking agencies recently estimated that complying with CRA data collection requirements entails ten hours a year of work by small banks. This is a *very* low level of regulatory responsibility for over four-fifths of the banking industry. Small banks themselves have commented on the ease of their CRA exams. We believe that small bank exams are too general (i.e., regulators must look at the "geographic distribution of loans," yet there is no description of what this entails) and do not provide adequate detail about an institution's performance nor provide any incentive for a bank to improve that performance. For instance, the exams focus primarily on lending—yet, the primary means by which regulators evaluate lending performance is through loan-to-deposit ratios. Especially since small bank exams focus on lending performance, they should be examined on the following issues, as are large banks:

- The number and amount of loans in low, moderate, and middle and upper-income geographies in the bank's assessment area(s);
- Borrower characteristics. The distribution, particularly in the bank's assessment area(s), of the bank's home mortgage, small business, small farm, and consumer loans, if applicable, based on borrower characteristics, including the number and amount of:
 1. Home mortgage loans to low, moderate, middle and upper-income individuals;
 2. Small business and small farm loans to businesses and farms with gross annual revenues of \$1 million or less;
 3. Small business and small farm loans by loan amount at origination; and
 4. Consumer loans, if applicable, to low, moderate, middle and upper-income individuals.

Information on non-lending related investments, retail services and community development services is absent in small bank exams and should be included. There is currently no incentive for small banks to consider innovative or complex programs in order to receive better CRA ratings.

Moreover, the Gramm-Leach-Bliley Act of 1999 further limited the relevance of small bank exams by reducing the frequency of such exams from every two to every four or five years. The infrequency of these exams seriously reduces any burden on such institutions, invalidating the argument that the regulations are too burdensome or restrictive for small banks.

We believe that all banks should be examined for their performance in providing loans, investments, and retail services in underserved areas and to underserved individuals. These exams should resemble large bank CRA exams and should employ similar quantitative and qualitative measures as well as emphasis on assessment areas, geographic distribution of loans, and level of service to low-income people.

Section 3: Limited Purpose and Wholesale Institutions: The Community Development Test

Question 1: Are the definitions of "wholesale institutions" and "limited purpose institution" adequate? If so, why? If not, how should the regulations be revised?

Answer: These definitions are not adequate. The implementation of the definition of wholesale and limited purpose institutions has included institutions that should clearly be regarded as retail financial institutions and subject to the full CRA examination. One problem is encapsulated in the FFIEC Questions and Answers in the Federal Register of April 28, 2000. The Q&A states that when determining whether or not an institution is a regular financial institution, the agencies will consider the following: Whether the institution holds itself out to the retail public as providing home, small business or consumer loans to retail customers; and whether the institution's revenues from such loans are significant when compared to its overall operations. However, a bank's retail activity may not seem significant compared to its other operations, but in a large institution, that activity may still be important in a particular market.

The definition of a limited purpose bank, which is defined as a bank that offers only a narrow product line (such as a credit card or motor vehicle loan), should also be revised. There is a huge disparity in terms of "limitedness" between a credit card bank and an auto loan firm. A credit card company can be a major lending presence even though that lending is a small portion of its activity measured by dollar volume. For example, American Express has 20% of the small business market in the Chicago six-county region and as such should be examined under the lending test. A bank should be considered a retail bank if a significant share of its lending is retail (housing or small business) OR if its market share of any product in any MSA or county is more than 0.5%.

Question 2: Does the community development test provide a reasonable and sufficient standard for assessing wholesale and limited purpose institutions? If so, why? If not, how should the regulations be revised?

Answer: If, and only if, the definitions of "wholesale institutions" and "limited purpose institution" are amended to take into consideration our comments to Question 1 of Section 3 of this ANPR, then the community development test would provide a reasonable standard for assessing the CRA record of such institutions.

Question 3: Would the community development test provide a reasonable and sufficient standard for assessing the CRA record of other insured depository institutions, including retail institutions? If so, why and which ones, and how should the regulation be revised. If not, why not?

Answer: It is quite disingenuous of the agencies to publish an ANPR that appears to take the structure of the 1995 regulation seriously and then proposes a question that challenges the basic structure of the 1995 revision. The chief virtue of the 1995 regulation is its emphasis on concrete measures of bank performance and its division of that performance into three major categories. That division permits a detailed examination of those categories which would be absent if they were collapsed in any way.

Section 4: Strategic Plan

Question 1. Does the strategic plan option provide an effective alternative method of evaluation for financial institutions? If so, why? If not, how should the regulations be revised?

Answer: The strategic plan option should be eliminated. It is essentially an abandonment of the agencies' responsibilities to implement and enforce CRA in a consistent fashion. The absence of any substantive guidelines for this option essentially enables banks to develop their own rating system with little or no regulatory oversight. Unless the system is rigorously reviewed to be a credible and fair evaluation scheme, it will simply assure an Outstanding rating. Goals can be set at such low levels that institutions could not realistically fail to meet them. Few banks have chosen the plan option either because some of the agencies have rejected plans that were clearly designed to assure an outstanding rating, or because other uncertainties exist with the process. The CRA evaluation process already provides ample flexibility for institutions that are unusual in some respect. If an institution does modest amounts of lending, or does not penetrate lower-income markets very well, it should be expected to perform much better than other institutions on the investment and/or service test to receive a Satisfactory rating. This is precisely the purpose of a weight-summed rating system.

If the strategic plan option is retained, the regulations should be revised to include individual component test ratings (Lending, Investments, and Services). Institutions submitting plans should be required to justify goals using comparative information from other financial institutions. For example, if a bank chooses the strategic plan option because it does little mortgage or small business lending, it might set a high goal for investments. It should document in the plan that this level of investment is high relative to those of other institutions of its size and in its market or a similar market. Moreover, if the strategic plan option is maintained, the public process that is currently in place in relation to the formation of such plans should be maintained; regulators should seek out as much community input as possible during that process.

Section 5: Performance Context

Question 1: Are the provisions on performance context effective in appropriately shaping the quantitative and qualitative evaluation of an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

Answer: Assessing the performance context for a bank's lending, services and investments is crucial for identifying opportunities for new bank products or marketing. The performance context should allow for an analysis of bank performance potential and allow community organizations to participate in the review process. Moreover, an analysis of the performance context can allow the performance of similar banks to be considered during evaluation.

Currently, the performance context is determined by regulatory agency reports; bank analyses; and discussions with community contacts. This procedure has a number of disadvantages and should be improved. For instance, at this point, the performance context does not incorporate economic and market assessments prepared by outside sources. Banks may use their own analysis as a rationale for poor performance. The performance context should allow for analyses conducted by community organizations and others. Community organizations are rooted to their neighborhoods and often take a comprehensive view of market opportunities.

Also, community contacts may be limited to community organizations identified by bank staff, when interviews should be held with a range of community organizations. Regulators should notify community contacts in advance of an interview and identify the bank being reviewed so that the community contact has a better understanding of the performance context. In addition, regulators should forward a draft copy of the performance context to the community group prior to the interview so that they have enough information to make qualified statements.

Moreover, there are elements of the performance context that could be uniformly assessed for whole MSAs for the purpose of efficiency (i.e., demographic information, which is consistent throughout a region). Finally, the performance contexts for services and investments are not routinely assessed. Service related issues include analyses of the unbanked population and identification of alternative financial service providers. The analysis of investment and grant opportunities should include analysis by community development financial institutions and others.

Section 6: Assessment Areas

Question 1: Do the provisions on assessment areas, which are tied to geographies surrounding physical deposit-gathering facilities, provide a reasonable and sufficient standard for designating the communities within which the institution's activities will be evaluated during an examination? If so why? If not, how should the regulation be revised?

Answer: The provisions on assessment areas are not reasonable or sufficient in today's market. The regulatory agencies have recognized the realities of contemporary banking in the interpretation of other regulations and in their support of the Gramm-Leach-Bliley Financial Modernization Act. Sadly, they have not recognized those realities in their treatment of CRA assessment areas. If financial institutions have some or all of their activity based outside of a branch network and those institutions are examined solely on the basis of the area around a branch, a central computer, or a home office, the spirit of the CRA statute is being ignored. The regulations should focus on who is and who is not being served, not on how they are served or the geographical locus of a particular method of delivering service.

The agencies should expand their current practice by allowing institutions to delineate assessment areas not only where they have their main office, branches, and deposit taking ATMs, but also where they take a significant portion of their deposits or make a significant portion of their loans. Thus, a financial institution should include the following in its definition of its assessment area:

- (a) MSAs or counties where it has branches and ATMs
- (b) and any MSA or non-metro county where it has originated a significant portion of its loans (i.e. 0.5%)
- (c) and any MSA or non-metro county where it has originated a significant portion of the total loans made in those geographies in the most recent year (i.e., 0.5%)

No large bank should be able to go below the country level when defining its assessment area in a particular MSA. For Internet-based or other types of banks with customer bases that are widely spread and do not fall with the parameters of (b) and (c) above, the bank's national aggregate market share of low- and moderate-income customers (for all product lines) should be compared to its national aggregate market share of middle- and upper-income customers. This market share ratio should then be compared to the national ratio of such households during CRA exams. The appropriate agency should also regularly evaluate a bank's delineation of its assessment area. The Institute is finding too many examples of assessment areas that disregard the requirements described in the 1995 regulation.

Section 7: Activities of Affiliates

Question 1: Are the provisions on affiliate lending activities, which permit consideration of an institution's affiliates' activities at the option of the institution, effective in evaluating the performance of the institution in helping to meet the credit needs of its entire community, and consistent with the CRA statute? If so, why? If not, how should the regulations be revised?

Answer: Affiliates' lending should always be examined in performance evaluations. The provision calling for review at the bank's option should be removed [229.229(c)]. Permitting this self-selection distorts the analysis in the performance evaluation. The option only works in one direction—to make the institution look better in the exam. If adding the affiliate does not make the bank look good, the institution will know that and opt for exclusion. This worsens the problem of overall rating inflation. In addition, when considering prime vs. subprime affiliates, the regulations should require that a performance evaluation include a comparative analysis of the lending patterns of the subprime and prime lending units.

At an absolute minimum, the regulations should clearly specify that an institution can choose only whether to have *all* affiliates included in the examination. It should not be allowed to have some affiliates included and others excluded. For example, a bank with two mortgage company affiliates, one specializing in prime lending and the other in subprime lending, should not be allowed to include only the lending of one of the two affiliates in the exam. Moreover, *all* residential, consumer and small business lending products of all affiliates should be examined.

Section 8: Data collection and Maintenance of Public Files

Question 1: Are the data collection and reporting and public file requirements effective and efficient approaches for assessing an institution's CRA performance while minimizing burden? If so, why? If not, how should the regulations be revised?

Answer: There are a number of important issues regarding CRA data collection and disclosure. First, small business data are critical to the meaningful evaluation of an institution's small business lending performance, which is a fundamental part of CRA. Without such data, there can be no meaningful regulation in this area. Thus, it is critical to the implementation of the statute. Second, notwithstanding the importance of the data, their current form severely restricts examiners and the general public from a better understanding of an institution's small business lending patterns and increases burden by creating a separate reporting regime for small business loans. A much better approach would be to revise the small business data format to mirror the Home Mortgage Disclosure Act (HMDA) format. Data should be reported on each loan application, including race and gender of loan applicants as well as industry, annual sales, loan size and disposition of the application. These data should be fully disclosed to the public. At an absolute minimum, the current limitations on the disclosure of the small business loan data (where individual institution data is released only in

summary format, by income level of neighborhood) should be removed. The public should have full access to the data in a similar form as they are reported to the agencies.

The 2001 change in the Q&A which permitted one small business refinance or renewal made within a year of the original loan to be counted as an additional loan should be rescinded. This provision gives institutions a perverse incentive to make short-term rather than long-term loans to get credit for more originations. Renewals or refinances should be separated from originations.

The community development lending data should be more detailed and consistent. They should follow the loan application register (LAR) format with information on the purpose of the loan (housing, business development, etc.) and the dollar volume of each origination.

Just as consistent data are needed to implement the lending test, the regulations should be revised to require detailed reporting of qualified investments and basic financial services. For investments, the reporting format should include the originated dollar amount, the term if any, and whether the investment is a grant. Institutions should be required to report data on account holders, including income, race, census tract of residence, average balance, type of account, and whether the account was opened in the reporting year. This information should be made available to the public by the agencies in a detailed, convenient form. Finally, in the future, banks' public files should be kept in bank branches and available to the public, as they are today.